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SUBJECT: Argentina Economic and Financial Weekly for  
the week ending March 23, 2006

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Weekly Highlights  
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- GOA runs an ARP 1.9 billion primary fiscal surplus in February - better than expected.
- January monthly economic activity index up 9.1 percent y-o-y - stronger than expected.
- GOA rescinds Aguas Argentina's concession contract and creates state water company.
- The poverty rate dropped 5.1 percentage points to 33.8 percent in the second half of 2005.
- The beef export ban will cost the GOA only ARP 184 million in lost tax revenue.
- GOA reaches a price-restraint agreement with fish producers.
- GOA issues USD 500 million of the new "Bonar V" bond.
- Investors concentrated more than 88 percent of their bids in BCRA Nobacs.
- Attorney General says Argentina "will respect" ICSID arbitration claims.
- Commentary of the Week: "The Economy Grew 30 percent in Three Years (But It's Not a Record)"

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ECONOMY / FINANCE  
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GOA runs an ARP 1.9 billion primary fiscal surplus in February - better than expected.  
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1. The GOA announced a primary fiscal surplus of ARP 1.9 billion in February, above market expectations of ARP 1.6 billion. This brings the accumulated fiscal surplus for the first two months of 2006 to ARP 3.5 billion. This better-than-expected February result is mainly the result of strong revenue collection. In February, revenues increased 29.4 percent y-o-y to ARP 12.8 billion, while expenditures rose 28.2 percent y-o-y to ARP 10.9 billion. The primary fiscal surplus increased 37 percent y-o-y. The BCRA consensus

forecasts an ARP 22.3 billion primary fiscal surplus for 2006.

January monthly economic activity index up 9.1 percent y-o-y - stronger than expected.

12. The monthly economic activity index increased a strong 9.1 percent y-o-y in January, well above the BCRA market survey forecast of 8.1 percent. The index remained flat m-o-m due to technical problems that halted some production in the industrial sector. The BCRA consensus survey estimates 7 percent economic activity growth for 2006. However, some private analysts predict growth as high as 8 percent. The monthly economic activity index is viewed as a reliable leading indicator of GDP.

The poverty rate dropped 5.1 percentage points to 33.8 percent in the second half of 2005.

13. On March 21, the GOA announced that the poverty rate fell to 33.8 percent in the second half of 2005 from 38.9 percent in the first half of the year, and down from 40.2 percent in the second half of 2004. The 33.8 percent poverty rate represents 7.9 million people. The GOA also said that the destitution rate fell from 13.8 percent to 12.2 percent in the second half of 2005, the latter representing 2.8 million people. The poverty and destitution rates are measured by a survey conducted in the twenty-eight largest urban areas of Argentina.

GOA rescinds Aguas Argentina's concession contract and creates a new state-owned water company.

14. On March 22, the GOA published a decree rescinding Aguas Argentinas's concession contract and creating a state-owned water company to provide water and sewage services in Greater Buenos Aires. Minister of Planning Julio De Vido said that the main reason for rescinding the concession contract was the detection of high level of nitrates in the water provided by Aguas Argentinas (controlled by the French Suez company). The new state-owned water company, AYSA (Agua y Saneamientos Argentinos SA), will be 90 percent federal government-owned and the remaining 10 percent will be held by workers. According to GOA officials, tariffs will remain unchanged. Suez has filed an arbitration claim against Argentina in the World Bank's International Centre for Settlement of Investment Disputes (ICSID) for USD 1.7 billion in losses allegedly caused by the freezing of tariffs in 2002

The 180-day beef export ban will cost the GOA ARP 184 million in lost fiscal revenue.

15. According to Embassy estimates, the 180-day beef export ban will cost the GOA around ARP 184 million in lost export tax collections, not a significant loss compared to monthly revenues of ARP 12.9 billion.

GOA reaches a price-restraint agreement with fish producers.

16. On March 20, the GOA closed a new price-restraint agreement with fish producers, freezing the price of two fish species until the end of the year. The new

agreement seeks to encourage consumers to buy beef substitutes and thus indirectly avoid further increases in beef prices. According to GOA officials, the accord was signed with seven fishing chambers, and it is subject to bi-monthly monitoring of any changes in costs.

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GOA issues USD 500 million of the new "Bonar V" bond.  
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17. On March 22, the GOA announced the issuance of USD 500 million worth of the new USD-denominated bond, known as the "Bonar V," maturing in 2011. The yield on the new bond was 8.36 percent, in line with domestic interest rates. Bids -mainly from foreign banks and local pension funds (AFJPs) - reached USD 726 million, enough to fill the USD 500 million auction amount. The Bonar V will amortize principal at maturity while paying interest every six months. The interest coupon was fixed at 7 percent per year in US dollars, paying 3.50 percent of nominal value.

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BCRA rolls over its maturities. Investors concentrated more than 88 percent of their bids in Nobacs.  
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18. The BCRA received ARP 234 million in bids at its March 21 Lebac auction, less than the 1.2 billion in Lebacs that came due during the week. However, the BCRA received ARP 1.8 billion in bids in its Nobac auction. [Nobacs are longer term instruments than Lebacs and pay a variable rate composed of base rate called Badlar -- the interest rate for deposits of

more than ARP 1 million, currently at 7 percent -- plus a spread. The BCRA auctions the spread on its Nobacs, while the Badlar is determined by market conditions.] As in previous auctions, the BCRA was able to roll over its maturities by accepting bids for ARP 1.2 billion (ARP 234 million in Lebacs and ARP 994 million in Nobacs). The yield on the 35-day Lebac and the 70-day Lebac remained unchanged at 6.7 percent and 6.95 percent, respectively. The yield on the 98-day Lebac dropped seven basis points from 7.35 percent to 7.28 percent, while the yield on the 168-day Lebac reached 8.35 percent. Lebacs for other maturities were withdrawn due to lack of interest. Investors concentrated more than 88 percent of their bids in Nobacs of more than 9 months and the BCRA accepted bids for ARP 994 million of Nobacs (81 percent of the accepted bids in the auction). The spread on the nine-month Nobac decreased seven basis points, from 3.07 percent to 3.0 percent, while the spread on the two-year Nobac dropped twenty basis points from 5.02 percent to 4.82 percent. Investors continue increasing their bids in Nobacs, since these instruments have a variable rate and provide a higher yield.

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Attorney General says Argentina "will respect" ICSID arbitration awards  
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19. On March 22, Attorney General for the Treasury Osvaldo Guglielmino told a press conference that Argentina "will respect" ICSID arbitration awards against it, even as he criticized the ICSID process for encouraging "overvalued" claims because it does not charge fees based on the amount of the claim (as Argentina does in litigation). He said that ICSID claims against Argentina are overvalued by 1000 percent.

The peso was unchanged against the USD this week, closing at 3.09 ARP/USD.

¶10. The peso remained flat versus the USD this week, closing at 3.09 ARP/USD. The BCRA purchased USD 102 million in the first four days of the week without any peso appreciation. The BCRA also purchased EUR 26 million in the FX market in the first two days of the week. The BCRA has purchased USD 2.1 billion since the beginning of the year, compared to USD 794 million during the same period last year. The peso exchange rate has depreciated 1.3 percent since the beginning of the calendar year.

Commentary of the Week: "The Economy Grew 30 percent in Three Years (But It's Not a Record)". By Abel Viglione. [Note: Translated and used with permission of the author, from an article published February 21 in Ambito Financiero. End Note.]

¶11. The data published by INDEC about GDP growth for 2005 is very good (9.1 percent, according to the EMAE) and confirms the strong recovery of the past three years, which has resulted in an increase in national wealth of 29.4 percent.

¶12. Given that the population grew at a 1 percent annual rate, the recovery in per capita GDP has been surprisingly high. While it has not reached the previous high (1998), it is very close, only 2 percent below it. Of course, measured in constant pesos, or measured in dollars, it is still far below its peak.

¶13. Let's forget about dollars and analyze everything in local currency. Argentine history shows five significant three-year economic expansions, and the expansion of the past three years is in fourth place, as you can see from the table below:

Argentina during Three-Year Expansions  
(In Percentages )

Period	GDP	Consumption	Investment	Exports	Imports
1887-1889	44.5	-	-	-	-
1903-1905	43.2	40.7	145.1	62.7	
1918-1920	31.7	21.2	118.9	95.9	52.1
2003-2005	29.4	25.1	121.2	27.4	135.0
1991-1993	28.2	36.8	98.7	-0.1	242.7

Period	GDP growth in 3 previous years	President
1887-1889	6.0	Juarez Celman
1903-1905	3.7	Roca/Quintana
1918-1920	-10.3	Yrigoyen
2003-2005	-15.5	Kirchner
1991-1993	-7.9	Menem

¶14. Periods of greater growth than the current period occurred during the governments of Juarez Celman (in

the three year period 1887-89, when the economy grew 44.5 percent), of Roca and Quintana (1903-05, with a GDP increase of 43.2 percent), and that of the first period of Yrigoyen (1918-20, with a 31.7 percent increase). The current expansion exceeds by only one percentage point the growth during the decade of the 90's (Menem), when GDP grew 28.2 percent between 1991 and 1993.

¶15. What differences can we observe between these three-year periods of strong growth?

¶16. That those at the end of the 19th century and beginning of the 20th came after prior periods of growth, for which they were "disadvantaged" in comparison to the present period; nevertheless, they produced higher rates of growth.

¶17. That in the years prior to the last three great expansions, GDP had contracted. That the largest contraction of GDP occurred prior to the current recovery; the GDP fell 15.5 percent between 2000 and 2002, for which the current recovery was "advantaged" from the outset in comparison with other expansions.

¶18. That GDP per capita rose in all cases in comparison with the three years prior to the expansion. In the expansion of 2003-05, the rise in per capita GDP was only 2.6 percent compared to that of 2000, while in the other four cases the increase was between 22.3 percent and 28.8 percent, a rate almost 10 times higher than the current one.

¶19. That consumption rose during all the expansions, and in that of 2003-05, it rose 25.1 percent. Nevertheless, consumption per capita remained below (-3.2 percent) the level prior to the crisis. The inverse occurred in the other expansions; it always increased, and did so by between 14 percent and 32

percent, even though the population increased at a 3.6 percent rate at the beginning of the 20th century.

¶20. Given that consumption represents 75 percent of demand, it is clear that the variation in GDP will be similar to that of consumption. In two periods, that is not what happened: in the expansion of 1918 to 1920, the drivers were investment and exports. In that of 1991 to 1993, the drivers were consumption (it was higher than the increase in GDP, which indicated an elevated increase in consumption by Argentine society) and investment.

¶21. The expansion of 2003-05 had as its drivers investment and exports. It is true that investment has increased substantially, 121.2 percent, but from practically nothing. It is enough to note that investment in 2002 was the lowest in Argentine history, not reaching 12 percent of GDP that year.

¶22. The most relevant point about this last expansion has been the strong growth in exports (27.4 percent), given that it follows a trend of 8 percent annual growth since 1987. In the decade of the 1990's, this didn't happen. In the other expansions, the growth of exports was much higher, which is reasonable given the greater openness of the economy to trade during those periods.

## ----- Conclusions -----

¶23. The current expansion has not been the most important of the past 100 years, as has been commented in some press reports in recent days.

¶24. The departure point for this expansion was very

low. It is enough to recall that GDP fell 10.9 percent in 2002, the biggest drop in percentage terms in Argentine history along with 1891, the only years in which GDP fell by more than 10 percent. This gave it a handicap in comparison with other expansions.

¶25. It is the only expansion in which per capita consumption remained below the year prior to the expansion, which indicates that the population as a whole consumes less than it did in 2000. The inverse occurred in the 1991-93 expansion, when exports per capita were reduced, i.e., we consumed locally a part of what had been dedicated to export, which also was not wise.

¶26. Argentina is not an island in regards to economic growth. The majority of the countries of Latin America grew in the past three years, producing double-digit rates of growth and taking advantage of the favorable international situation.

¶27. In conclusion, the current recovery has been excellent and, if we want it to rise in the historical rankings, we will need to increase investment in a very serious way to maintain GDP growth rates of 5 percent per year. It will be necessary for investment and exports to increase faster than GDP, which implies that consumption will have to grow at lower rate, resulting in a drop in the consumption-GDP ratio.

[Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.]

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